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American Electric Power
Three James Center
1051 E. Cary Street, Suite 702
Richmond, VA 23219-4029
www.aep.com

April 17, 2003

Ms. Susan D. Larsen, Deputy Director
Division of Public Accounting
State Corporation Commission
1300 East Main Street
Richmond, VA 23219

Re: Stranded Cost Working Group Comments

Dear Ms. Larsen:

At the meeting of the Stranded Cost Working Group on April 7, 2003, two potential methods for monitoring stranded cost recovery were discussed. First, a methodology described in the written comments of Dominion Virginia Power was briefly noted. Second, Mr. Howard Spinner presented a proposed monitoring methodology ("Staff model"). You requested the participants in the meeting to provide written comments on these two methods. Appalachian Power Company ("Appalachian" or "Company") submits this letter in response to your invitation.

While the Company would support the Dominion Virginia Power stranded cost monitoring model as an approach to monitoring stranded cost recovery consistent with the Act, Appalachian continues to be concerned about the lack of development - both to date and anticipated - of a competitive retail market in Virginia and the clear implications of this condition for the LTTF's over/under-recovery assessment.

The applicable resolution of the Legislative Transition Task Force ("LTTF") requires this Working Group to develop "consensus recommendations, consistent with the provisions of the [Virginia Electric Utility Restructuring] Act … ." In the Company's view, Dominion Virginia Power's proposal is generally consistent with the framework of the Act, while the Staff model is inconsistent with the existing provisions of the Act. The Staff model would require fundamental changes in the Act and would be little different than traditional utility rate regulation.

Section 56-584 of the Act provides, in pertinent part, that "… each incumbent electric utility shall only recover its just and reasonable net stranded costs through capped rates as provided in § 56-582 or wires charges as provided in § 56-583." Section 56-595 C (iii) of the Act provides, as relevant here, for the LTTF to inquire as to "…whether the recovery of stranded costs, as provided in § 56-584, has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs … ." Neither of these sections says anything about the calculation of stranded costs except that the LTTF monitoring is to be consistent with § 56-584 which, in turn, requires recovery of stranded costs to be in accordance with the capped rates and wires charges sections of the Act.

The remainder of the Act avoids the necessity to make initial or periodic stranded cost projections, and the Staff of the Commission had advised the General Assembly at the time the Act was adopted that efforts to project stranded costs at the outset could result in "disaster". The correct interpretation of § 56-595 C (iii), and the Paragraph 1 of the LTTF resolution, is that the LTTF should monitor recovery of stranded costs under the existing provisions of the Act. The correct question for the Work Group to deliberate, therefore, is: Are there methodologies to monitor recovery of stranded costs which do not involve an administrative projection of stranded costs not informed by the current provisions of the Act, but which also provide the LTTF an ability to evaluate the likelihood of reasonable recovery of stranded costs?

Dominion Virginia Power has already identified one methodology that would monitor the recovery of stranded costs under the existing provisions of the Act. The Dominion Virginia Power model would monitor the accuracy of the projected market prices for electric generation consistent with the revenue neutrality principle that the Commission has already approved for estimating generation market prices for computation of wires charges. The Company does not disagree that the Dominion Virginia Power model should be considered further as a methodology consistent with the existing provisions of the Act.

The Staff model, on the other hand, assumes that the Commission would make a mid-course projection of stranded costs over the life of the relevant assets. This assumption, while not yet fully explored by the Company, is inconsistent with the existing provisions of the Act, and there is nothing in the Act that gives any guidance as to the manner in which such a projection should be made. The Staff model is, therefore, in conflict with the provisions of the Act in this respect. Legislative guidance and fundamental statutory changes would be required prior to any attempt at its implementation.

The Staff model also apparently intends that revenue from capped rates be compared to some form of an on-going cost-of-service standard and that the result could change stranded cost recovery from time to time. The effect would be that capped rates could be changed on a cost-of-service basis periodically. The provisions of the Act, however, do not contemplate adjustments to capped rates, except in the limited fashion delineated in those provisions. The fundamental concept of the Act was that incumbent electric utilities would be entitled to, and would accept the risk of, the rate levels established in the Act for a limited period of time (until July 1, 2007). The Staff model would appear to suggest critical changes in these provisions of the Act based solely on reliance on the single provision that requires monitoring of stranded cost recovery.

The Staff model could also be interpreted to operate without regard to the admonition of the Act that "positive" net stranded costs are recoverable under § 56-584 and that no wires charges should be less than zero under § 56-583. Read together, these provisions make clear that the stranded cost recovery mechanisms in the Act are not intended to permit re-argument of "negative wires charges" and related issues that have long been resolved. If the Staff model is to be further considered by the Working Group, it will reopen fundamental restructuring issues that have been resolved for several years.

The Staff model begins with stranded cost recovery methodologies considered in other jurisdictions and in other circumstances; however, those methodologies are not applicable to the Act or the current situation in Virginia. The Staff suggests that its model is similar to models involving "going-in" estimates of stranded costs for purposes of establishing a specific stranded cost recovery component. Any such component could then be continuously evaluated during any transition or market development phase. This approach was specifically rejected in Virginia. The Staff model would introduce the need to estimate stranded costs and make assumptions about a number of variables. The provisions in the current legislation established four years ago avoid the uncertainty associated with making such estimates and assumptions. In addition, there are elements of the Staff model which are simply not clear in terms of process and provisions. Even if the LTTF resolution were read as an instruction to produce stranded cost projections not contemplated by the current provisions of the Act, the Staff model would remain in conflict with important features of the Act and require significant statutory change.

There is no justification to read § 56-595 C (iii) out of context to suggest that it reverses all of the other provisions in the Act that govern stranded cost recovery, capped rates and wires charges. The Working Group should concentrate on exploring whether the Dominion Virginia Power proposal can be developed to meet the needs of the LTTF or whether other models consistent with the Act can be identified. If further consideration of the Staff model is to be undertaken, it should be made clear in the Staff report to the LTTF, from the outset, that adoption of such a model would require that fundamental changes to many aspects of the current Act be adopted by the General Assembly.

Thank you for the opportunity to present these preliminary views on the proposals discussed at the April 7 meeting, and the Company looks forward to further participation in the Working Group deliberations.

Sincerely,

Barry L. Thomas

Barry L. Thomas, Director
Regulatory Services VA/TN

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